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**U.S. House of Representatives**  
**Committee on Financial Services**  
2129 Rayburn House Office Building  
Washington, DC 20515

September 13, 2005

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STAFF DIRECTOR

The Honorable Alan Greenspan  
Chairman  
Board of Governors of the Federal Reserve System  
20<sup>th</sup> and Constitution Streets, N.W.  
Washington, D.C. 20551

Dear Chairman Greenspan:


We were disturbed by the attached American Banker article suggesting that Federal Reserve Board staff are actively discouraging Federal Reserve Bank staff from expressing independent views on the Basel II Capital Accord.

This is a very important issue as you know and it is necessary for Congress to be fully informed. Clearly, it is inappropriate for there to be any effort to interfere with the information Congress receives. If this article is accurate, we ask that you please take the necessary steps to ensure that no Federal Reserve official interferes with Congress's access to information.


Yours truly,




BARNEY FRANK  
Ranking Member



MICHAEL G. OXLEY  
Chairman



CAROLYN B. MALONEY  
Ranking Member  
Subcommittee on Domestic and  
International Monetary Policy,  
Trade, and Technology



SPENCER BACHUS  
Chairman  
Subcommittee on Domestic and  
International Monetary Policy,  
Trade, and Technology

Enclosure

# **In Focus: Stress Shows At Fed with Basel II Drive Sputtering**

American Banker << OLE Object: Picture (Metafile) >> Monday, August 29, 2005

By Damian Paletta

WASHINGTON - The Federal Reserve Board faces a series of daunting challenges to keep Basel II on track, including internal divisions, fights with fellow regulators, and possible congressional interference.

The central bank last week urged its 12 banks to fall in line and communicate a unified message on Basel II as it prepares for a major strategy meeting next month with the other banking and thrift agencies. It also has repeatedly disputed charges it is bullying its fellow supervisors into adopting the plan, and that once implemented it would result in steep drops in capital at banks.

The stakes are high for the Fed, which has taken the lead domestically to complete the capital accord and hopes to have it implemented by 2008. But the agency is facing increasing skepticism it can release the next stage of the plan in order to meet the deadline.

A sign of the mounting pressure came last week when the agency's director of supervision sent a memo to all 12 regional banks the same day a front-page American Banker article said the effort was stalling. Trying to ensure the Fed speaks with one voice on Basel II, Richard Spillenkothen said he would soon issue question-and-answer sheets that Fed officials should use when discussing the capital standard with outsiders.

"During this period of continued negotiation and development around capital reform, it is critical that Board staff and Reserve Bank staff have good communications and coordination of activities," Mr. Spillenkothen wrote.

Observers said the Fed wants to keep strife within the agency from showing.

"There is obviously a high level of concern within the Fed, particularly at the board, about where Basel II is going," said Bert Ely, a banking analyst in Alexandria, Va. "They don't want anybody talking out of school. They want to reinforce that 'We are going to speak with one voice and that voice is going to come from Washington.' "

There has already been some disagreement. In April three economists with the Federal Reserve Bank of St. Louis wrote in *Regional Economist*, a quarterly magazine the St. Louis Fed publishes, that community banks could face a mortgage pricing disparity because large Basel II banks with lower capital requirements could cut loan prices.

Basel II banks "may be able to offer more competitive lending rates" than other banks, St. Louis Fed President William Poole wrote in an introduction to the article. "Banks not operating under Basel II, then, may have to look for loan opportunities that are not affected as much by the new approach."

The article contradicted a much-anticipated report released in April by four Fed economists, who said Basel II banks would continue to set their mortgage prices by secondary-market requirements, not capital levels. An earlier version of that report, by former Fed economists Paul Calem and James Follain, was not published, but its conclusions also supported the view that Basel II would give large banks an advantage.

Mr. Spillenkothen's memo also asked the Reserve banks to tell the Fed what bankers are saying about Basel II, as well as "other supervisory efforts related to economic capital, risk measurement, or risk management."

"This clearly shows that there is a level of concern at the Reserve banks, but it doesn't mean that the Basel process is going to blow up," said Jaret Seiberg, a policy analyst for the Stanford Washington Research Group.

A Fed spokesman downplayed the memo, saying it "is not unusual for the board to coordinate with the Reserve banks on policy issues, particularly during important stages in their development - such as this one during the implementation of new capital regimes in the United States."

Some industry representatives said the Fed was trying to respond to a growing perception that the Basel II process has gone astray.

"There's a lot of questions going around about who should say what," said Pamela Martin, director of regulatory relations for the Risk Management Association. The Fed "needs to have a coordinated effort to get everybody on the same page. You want your examiners on the same page, especially when there are tons of rumors flying around. ... That's just good management."

The memo also underscored that some Fed officials are personally invested in the Basel II process.

"There is a pride of ownership at the Fed regarding the Basel committee," said David Fanger, the senior vice president of the banking group at Moody's Investors Service Inc.

A major impact study released in April handed critics - including other regulators - evidence that Basel II capital requirements might have flaws. The study, called QIS-4, showed an uneven spike and drop in capital requirements among banks, even at financial institutions with similar risk portfolios. Regulators had repeatedly promised capital levels would remain flat.

Federal Deposit Insurance Corp. Chairman Don Powell used the study as proof the process should slow down, despite the Fed's effort to issue a new proposal by yearend. He has said he does not expect regulators to have ironed out their differences in time. Some lawmakers have publicly said the Fed is rushing the other regulators - a charge the central bank denies.

Though Fed officials have maintained they could still make the deadline, Mr. Spillenkothen signaled in the memo that this was increasingly unlikely.

"We expect that this deliberative process, including the comment periods and requirements for OMB review, will extend well into next year," he wrote in the memo.

If U.S. banks are to implement Basel II by January 2008, all their systems would have to be in place by January 2007, because regulators want to run both the old standards and the new ones simultaneously for testing. That would give banks several months at the most to bring their systems into compliance once a final rule is issued.

Top federal regulators are expected to meet again next month ahead of an Oct. 3 Basel Committee on Banking Supervision summit in Switzerland to attempt to iron out their differences.

The Fed could also see Congress take a more active role. Senate Banking Committee Chairman Richard Shelby criticized the plan last month and said he wants to hold a hearing on the process in September or October.

"I'm not fully confident that the so-called 'right standards' have been proposed," Sen. Shelby said.

House Financial Services Committee Chairman Michael G. Oxley has threatened to pass a bill that would require the Treasury Department to step in if interagency conflicts on Basel II persist.